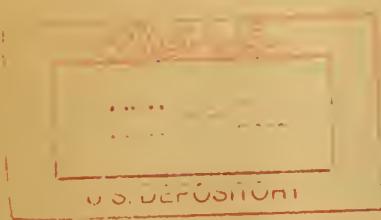


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FIELD WAREHOUSE RECEIPTS

Collateral or No Collateral

By

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Foreword

In the administration of the United States Warehouse Act, the Bureau of Agricultural Economics of the United States Department of Agriculture, which is charged with its administration, receives many inquiries regarding field warehousing. They come from processors and merchandisers of agricultural products, from growers cooperative associations, and from bankers and other lending institutions which extend credit on the basis of warehouse receipts covering agricultural products as collateral.

These inquiries reveal a deplorable lack of knowledge of the basic principles of warehousing that must be observed if warehouse receipts are to constitute sound collateral. The purpose of this discussion is to supply the apparent need for a fairly comprehensive statement of the principles involved in field warehousing as they relate to the extension of credit.

FIELD WAREHOUSE RECEIPTS

Collateral or No Collateral

The storing of agricultural products is not new. Usually the storing of agricultural products in public warehouses is for one of two purposes--for future need or for credit. Frequently storage is for both purposes, especially on the part of merchandisers and processors of agricultural products. During the past fifteen years in many agricultural producing areas there has been an increasing tendency on the part of the producers themselves to store for both purposes.

When products are stored for credit purposes it has been the general rule that such products should be surrendered to the custody of someone wholly independent of the one who stores. The person with whom products are stored is generally called a warehouseman. When goods are stored with a warehouseman he issues to the storers a receipt which is generally termed a warehouse receipt. It is symbolical of the products themselves. It is this warehouse receipt which the storer offers to his banker or lender as collateral for a loan.

FACTORS THAT MAKE RECEIPTS VALUABLE

The collateral value of warehouse receipts depends upon several factors, the principal of which are:

- (1) Suitability of the warehouse or storage facility for storing the product;
- (2) Responsibility of the warehouseman;
- (3) Competency of the warehouseman and his assistants to properly care for the product while in storage;
- (4) Authority of law under which the receipt is issued;
- (5) Information on the warehouse receipt itself which will give to the lender a concise yet comprehensive description of the product and thereby enable him to form an opinion of its fair market value;
- (6) Terms of the warehouse receipt in general;
- (7) Whether there is bonded responsibility back of the receipt, and, if so, by whom the bond is written, for the benefit of whom, with whom the bond is lodged, under what conditions it may be realized upon by the holder of the receipt, and what action such receipt-holder must take to realize upon the bond;
- (8) Whether the receipt represents a bona fide relationship of bailor and bailee between the storer and the warehouseman and one under which the warehouseman and his representatives or his local custodians are completely and wholly independent of the storer.
- (9) The character and extent of disinterested supervision exercised over the warehouse.

It is hardly necessary to comment in detail upon these various elements save the fifth and the eighth. As to the fifth factor, it is of course obvious that since the warehouse receipt represents the product stored in the warehouse it should contain such information as will convey to anyone to whom the receipt is offered for collateral purposes a fair, honest, and impartial description of the products themselves so as to enable one to form an opinion of the fair value of the product, and to identify it. This becomes all the more important when the storers seeks credit at some distance from the warehouse.

One of the first questions asked of a person seeking a loan by anyone engaged in commodity financing is: What is the commodity you propose to give as security? In the opinion of some lenders certain commodities are bankable or proper collateral. To other lenders these same commodities would not constitute proper collateral. Hence, when a loan is desired on products or commodities in storage, it is important that the warehouse receipts covering such commodities clearly recite just what the commodities are which the receipts represent.

Obviously, a receipt that conveys no information as to the quantity, quality, grade, or condition of the product, or that fails to state what the product actually is, does not inform the lender on points that are essential to making a fair and sound loan. It does not enable the lender to tell whether the product is even a proper subject for collateral. Receipts that recite that the warehouseman received a certain number of cases or bales or packages "said to contain" canned tomatoes or wool or fancy cigar-leaf tobacco give neither the storers nor the lender an index as to the value of the product represented by the receipt. And receipts which merely acknowledge that the warehouseman has received a certain number of cases or bales or packages and then recite "contents unknown" are not only of less value, but are a clear attempt on the part of the warehouseman to escape all liability so far as the commodity is concerned.

Under either the receipts which recite "contents unknown" or "said to contain," so far as the warehouseman is concerned and his liability to deliver a specific product, the cases or packages covered by the receipts might be filled with sawdust or mere trash.

To a lender who has given no more than superficial thought to making loans on the basis of warehouse receipts as collateral, any receipt that contains such statements as "said to contain" or "contents unknown" must have no appeal whatever as collateral.

The eighth factor -- a bona fide relationship of bailor and bailee between the depositor and the warehouseman, or the creation of a completely disinterested custodianship -- is always desirable in the financing of warehoused products, and it is essential in a field warehousing arrangement. Only to the extent that the warehouseman is wholly independent of the storers is there a disinterested custody of the product.

The importance of a disinterested custodianship of the product grows out of the fact that when the storers offers his warehouse receipt to the lender as security for a loan he proposes to pledge the products in the warehouse covered by the warehouse receipt. It is the products that are the real security. It is essential to the validity of a pledge that the pledgor surrender possession of the thing pledged. He cannot pledge an article and at the same time keep it. In other words, so long as the products are pledged as security for a loan they must remain in the custody and exclusive control of someone other than the borrower. "The borrower and his collateral are best parted."

In attempting to establish a disinterested custody the person who desires to borrow on the products should not content himself with representations of those who wish to serve him as warehouseman. Nor should he be content with something in the way of warehousing which he thinks may get by his banker; neither should he attempt short cuts to save a little cost.

In testing collateral, the real issue always is: Has there been an absolute and unequivocal parting on the part of the borrower with possession of the products he proposes to give as security for the loan? That question the owner of the products can easily determine for himself. All he needs to do is to ask himself and honestly answer the question: Under the proposed form of warehousing have I at any time access to the products other than in the presence of the warehouseman and may I at any time exercise any control of the products? If the answer is in the affirmative to the slightest degree, possibility of trouble in the warehousing arrangement exists. "The borrower and his collateral are best parted," and there is no absolute and unequivocal parting such as the law contemplates if the borrower has access to his collateral at his own pleasure or can exercise any control over it.

REQUIREMENT OF FEDERAL RESERVE ACT AND REGULATIONS

The principle of disinterested custodianship is recognized in the Federal Reserve Act and in the regulations thereunder of the Board of Governors of the Federal Reserve System relating to the eligibility of bankers' acceptances for rediscount by Federal Reserve Banks. Section 13 of the Federal Reserve Act requires that a banker's acceptance drawn to finance the storage of readily marketable staples shall be "secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title 1/ covering readily marketable staples." Section XI of Regulation A of the Board of Governors requires that "a banker's acceptance drawn to finance the storage of readily marketable staples shall be secured at the time of acceptance by a warehouse, terminal, or other similar receipt conveying security title to such staples, issued by a party independent of the customer." 1/

The requirement of the Federal Reserve Act that such warehouse receipts must convey or secure title to the products represented by the receipts obviously contemplates that the accepting bank shall have a lien on such products which is valid and enforceable against general creditors of the person for whose benefit the acceptance credit is granted. The regulation of the Board of Governors that such warehouse receipts shall be issued by a party independent of the customer obviously is intended to require that the actual custody of the goods shall be maintained by an independent and disinterested party so the bank that holds the warehouse receipt may be able to identify and obtain possession of the products and thus enforce its lien without difficulty.

A lien on personal property is of no practical value unless such property can be found and identified when it becomes necessary to enforce the lien. If custody of the pledged products is not given to and maintained by a disinterested party, there is grave danger that the borrower will be able to dispose of or release the products in such manner that innocent purchasers will acquire good title to them, and the lender's security will thus be entirely destroyed.

1/ Underscoring by author.

DISINTERESTED CUSTODIAN PRINCIPLE RECOGNIZED BY COURTS

The principle of disinterested custodianship has been repeatedly recognized by the courts, particularly where there is a conflict of interests. In one leading case the Supreme Court stated: "In this conflict of interests, the law wisely interposes. It acts not on the possibility, that, in some cases, the sense of that duty may prevail over the motives of self-interest, but it provides against the probability in many cases, and the danger in all cases, that the dictates of self-interest will exercise a predominant influence, and supersede that of duty." In a New Jersey case the principle was stated thus: "So jealous is the law upon this point that a trustee may not put himself in a position in which to be honest must be a strain on him."

Obviously, the person who is seeking credit, and offering stored agricultural commodities as collateral, is not a disinterested custodian, and neither is he free from that conflict of interests to which the Supreme Court referred in the quotation above cited. As has many times happened, a borrower who attempts to serve as the custodian of the collateral places himself in the position where "the dictates of self-interest will exercise a predominant influence and supersede that of duty."

In the light of these observations, the establishment between the storers of goods and the warehouseman of a relationship of bailor and bailee, and of complete independence between the storer and the warehouseman and his agents, becomes all the more indispensable.

These preliminary observations, which apply to the warehousing of agricultural products in the sense that the public, the banking fraternity, and the courts generally think of warehousing of products that are to be used as collateral for credit purposes, are equally applicable to a consideration of field warehousing. The same requirements must be observed if a field warehouse receipt is to stand the acid test to which it will be subjected if a question is raised as to its validity as collateral.

FIELD WAREHOUSING

What is field warehousing? In the last 5 years much has been written on this subject. Some writers have approached the subject as though they had found a wholly new method of financing crops while in storage awaiting demand; still others as though they had found a formula for financing in a big way a man who is entitled to little if any credit. A few writers have used the subject as a vehicle to attack other approved methods of warehousing because those methods diverted revenue from those making the attack. Other articles that were ostensibly about field warehousing gave the uninitiated and uninformed little basic information on the subject but have complained of alleged evils in subsidiary warehousing, quite ignoring the fact that subsidiary warehousing is authorized by statute and has met with court sanction in a number of States. Some of the authors who complained about subsidiary warehousing ignored the fact that they themselves were engaged in a subsidiary warehouse operation. Many of the articles on the subject had the earmarks of super-salesmanship, and an attempt to promote business on a shoe string.

In all that has been written about field warehousing it is regrettable that so few articles are really informative as to basic facts that are essential to the patrons of warehousemen and to the lenders who wish to make sound commodity loans. From many articles that have appeared it is impossible for anyone to draw the essential principles. Even those who conscientiously seek dependable information have been confused.

FIELD WAREHOUSING GOVERNED BY PUBLIC WAREHOUSE PRINCIPLES

There is nothing new or mysterious about field warehousing. Reference to decisions of courts show that the subject has been before the courts for the last 40 years, if not longer.

The principles involved in public warehousing in the generally accepted meaning of the term are well known. They have been established by a long line of judicial decisions. Field warehousing, being but an off-shoot of public warehousing, is governed by the same principles of law and finance. In the apparent attempt to advance the theory that a new method of financing has been developed, no claim is made that new principles have been developed. Rather, the claim is made that new procedures and methods have been originated.

It is an apparent attempt to short-cut established rules and principles, while at the same time professing that the established rules and principles of public warehousing are being observed in everyday operation. To the extent that these make-believe observations and short-cuts and shams are injected into field warehousing, to that extent are the warehouse operations and the warehouse receipts issued thereunder likely to fail when a real legal test is applied.

Field warehousing is a plan to store on the premises of the owner the very products on which he desires to effect a loan at the least cost to himself. The motive back of any field-warehousing arrangement, as far as the storers are concerned, is a desire on his part to enlarge his credit. In other words, he endeavors to place his products in a position that will enable him to pledge them as collateral to a loan. Almost without exception as soon as the credit need passes the field-warehouse arrangement also passes.

Placing the products in a credit or collateral position could be accomplished by placing them in storage in a public warehouse, but there might not be a public warehouse in the town in which the owner of the products operates. Moreover, the owner of the products frequently owns or controls a warehouse or storage facility. The very nature of his business frequently obliges him to have storage facilities. Naturally he wants to use them to greatest advantage. Again, he may wish to avoid unnecessary freight hauls. Further, he may feel that he can make sales and shipments to greater advantage from his own warehouse facility than from some other warehouse.

Field warehousing is seldom resorted to except by merchandisers or processors of products. Therefore, growers of agricultural products do not use this system of warehousing as individual producers. They generally store in public warehouses if they wish to use warehouse receipts for financing purposes. However, a group of growers such as a cooperative association may use field warehousing, but only when the association has a warehouse of its own that it desires to use.

The principal users of field warehousing in the agricultural field are canners of fresh fruits and vegetables, some grain merchants who have their own elevators, crushers of cottonseed, a few sugar and rice dealers, and some growers' cooperative associations whose members produce grain and fresh fruits and vegetables for canning or other purposes.

In a field-warehousing plan that will stand the crucial test, the merchant (or the growers' association) leases his warehouse to a party who is in no way interested in or related to the merchant (or the growers' association), to operate it as a public warehouse.

The lessee takes complete charge and control of the building by virtue of a valid lease. He receives the lessor's products in storage just as he would receive the products of a farmer or any other storero. In other words, the lessee -- the warehouseman -- must assume full responsibility for the operations of the warehouse. The only relation between the warehouseman and the owner of the warehouse should be that of lessor and lessee, and bailor and bailee if the lessor stores products in the warehouse.

In some parts of the country it is not uncommon for a warehouseman who operates in some city to lease a number of warehouses at a number of different points throughout a State, or several States, and operate these on the principle of field warehousing.

Field warehousing is sound if proper precautions are taken scrupulously to establish and to maintain the relationship of bailor and bailee. This means a meticulous observance of all the legal requisites essential to such a relation. Short-cuts on the plea of lowering costs have no place in field warehousing. The principle of disinterested custodianship must be strictly observed. It will not do for a warehouseman to lease a building and then let the lessor or employees of the lessor who may wish to store therein run the warehouse and conduct it just the same as before the lease arrangement was made.

In sound field warehousing the lessee must exercise complete control and dominion at all times over the warehouse and the products stored therein. This does not necessarily mean that the lessor must be denied access to the warehouse at all times, but it does mean that he must be denied access except in the presence of the lessee or his duly constituted agent, as in the case of other public warehouses. The mere leasing of premises to another who represents himself as a warehouseman and as in charge of the building will not in itself suffice. And recording of the lease, even if there is a statutory requirement for the recordation, in and of itself will not give validity to the warehouse receipts. Recording is only an attempt to give notice that the premises have temporarily passed from the real owner to another. But if the recording is not required by law, such recordation is not even constructive notice.

In sound field warehousing the warehouseman must take and must maintain actual possession of the building and the goods at all times. Such possession must be exclusive and unequivocal, and open and notorious, so that other creditors of the owner of the goods may not be misled. A sufficient number of signs of such size as readily to attract the notice of the public, clearly indicating that the premises are in the control of the warehouseman, must be placed inside and outside the buildings or premises. They should appear at all points of entry and exit to the premises.

But all the leases, recorded or not, and all the signs, large or small, inside and outside of the warehouse, will not serve to save the receipts from fatal legal attack if it can be shown that collateral and supplemental agreements existed between the warehouseman and the owner of the property, which were in violation of well-established legal principles. Again, if at any time the validity of the receipts should be attacked it would probably be disastrous if it could be established that the storero whose receipts are in question had a key that permitted him free access to the warehouse.

Moreover, it would be most unfortunate for the lender as holder of such collateral if it were shown, as is frequently the case, that the storero not only had a key to the warehouse, but that he entered at his pleasure, and sampled and inspected the goods in the presence of prospective buyers, when neither the warehouseman nor his local custodian was present. That is not the kind of open, notorious, unequivocal, and exclusive control that the law contemplates.

The words used by a court in an outstanding case may not be passed over lightly:

"Delivery of possession is of the very life of the pledge. No mere agreements respecting possession can create it. The contract of pledge cannot exist outside of the fact of change of possession. The pledgor must dispossess himself openly, completely, unequivocally, and 'without deceptive combinations which lead third persons into error as to the real possessor of the thing', and the pledgee must take and maintain an open, exclusive, and unequivocal possession."

In another celebrated case the court said:

"The general law of pledging requires possession and cannot exist without it. * * * Merely colorable or constructive change of possession accomplishes nothing in favor of a pledgee. There must be open, visible, unequivocal change of possession manifested by such substantial outward signs as to make it evident to the world that the control of the owner has wholly ceased, and that another has acquired; and is openly exercising the exclusive dominion over the property."

There is no room for make-believe, pretense or sham in field warehousing. No stronger language could be used to condemn an intent to make one believe that a disinterested custody existed when it did not in fact, than was used in a celebrated case in which the court said:

"There was really no delivery and no change of possession, continuous or otherwise. The alleged change was a mere pretense, a sham."

Nor is the collateral value of receipts improved by a statement thereon that they are issued in conformity with the Uniform Warehouse Receipts Act. That Act has no administrative provisions. It relates merely to the form of the receipt to be issued. Even when a receipt complies in every respect with that Act it leaves much to be desired from a collateral standpoint. In fact, a receipt issued in full compliance with that statute ordinarily fails completely to give information to the lender as to what the commodity is that the receipt represents, or its condition, or quality, or quantity.

Each lot of goods covered by a receipt, unless stored on a fungible basis, must be segregated from goods of others, including other goods of the owner, and the lots must be so marked as to permit identification readily on the basis of the information appearing on the warehouse receipt.

Warehouse receipts must be issued by a party independent of the customer. This does not mean the mere perfunctory signing of warehouse receipts by the president or other official of a warehouse company. A receipt is issued by and in the name of the warehouseman, whether he be an individual, a partnership, or corporation. It is the warehouseman as such who must issue the receipts. He is supposed to be the real custodian and the only custodian of the goods, and his warehouse receipts represent that he alone is the custodian. Therefore, regardless of legal fictions, sound business principles dictate that he should be wholly independent of the storer, and in no way related to the storer financially, by stock ownership in a storing corporation, or by virtue of interlocking directorates or officials, or by blood or kin relationships.

THE CUSTODIAN

Who may be a custodian? The answer is simple. Anyone who is competent to care for the goods that are to be stored, who is honest, and who is independent of the storers in every sense.

When a warehouseman operates more than one field warehouse he uses at each building or warehouse a custodian who is supposed to be his agent, and his only. This custodian is the key man. He may make or defeat the whole operation. It is essential that he should be as free and disinterested of any storers as the warehouseman himself. The degree to which he is disinterested may determine the validity of the receipts themselves.

What are the requirements of a custodian? These the United States Department of Agriculture has outlined in Service and Regulatory Announcements No 136, (B.A.E.), Sections 5 and 6, issued September, 1932. After years of experience in this field and careful observation of what actually takes place in every-day operation in field warehousing, and after careful and exhaustive study of adjudicated cases, the Department is convinced that these requirements are the minimum that should be exacted. Anything short of that is fraught with danger.

It is always highly important that the custodian arrangement be carefully scrutinized for the custodian is the key man. He is the man who controls. If he fails, all fails. No lender can afford to take any representations on this subject unless they be by wholly disinterested parties who are competent to investigate. Repeatedly the attempt has been made to convey the impression under certain field-warehousing set-ups that the custodian is independent of the borrower and that he is solely the warehouseman's own employee. The following is quoted from an article that recently appeared in print:

"Loans secured by field warehouse receipts covering currently salable merchandise are made by many large commercial banks. The bank cannot take physical charge of the goods offered as collateral, so some device is needed to give the bank the protection of the value of the merchandise. Field warehousing provides the means of getting this protection by providing a way of placing the goods in the hands of a disinterested and independent third party. The third party in this case is the warehouse company operating what is known as 'field warehouses.' * * *

"Goods and chattels are in the possession and charge of the warehouse company which maintains a custodian on the premises where the goods are stored. This custodian is properly bonded and supervised by the warehouse company."

The word "device" here is in itself suggestive. Webster defines it as "anything fanciful and ingeniously conceived, a scheme." No device is needed to give the banker protection for the merchandise. Public warehousing has been in existence for years and generally gives a degree of disinterested custodianship equal to the best system of field warehousing.

The custodian is an integral and vital part of any field warehousing operation. To say that he is bonded and is supervised by the warehouse company does not lend any more weight to the legality of his appointment, nor does it establish that he is a proper person to serve as custodian.

Bonding at its best is a relative term. But it might be well to scrutinize the terms of the bond to see what it covers, in whose favor it runs, under what conditions the holder of the receipt can recover, whether the surety is financially responsible, whether one might be obliged to incur heavy expense or even a trip abroad in trying to recover, the maximum amount of recovery possible, and how many operations of the same warehouseman are subject to the same bond.

It is always in order to investigate the custodian carefully. What does he know about caring for the goods in storage? What is his reputation? What has been his past connection? Has he been in the employ of the storer in the warehouse, or the borrower? If so, when, and what were his duties? By whom is he now employed, and who pays him? If he has been taken from the employ of the borrower on the eve of the creation of the warehousing arrangement, and transferred to the warehouseman's pay roll, this should cause one to pause, for, as one lender who has wide experience in commodity financing expressed it: "No barrier of legal sophistry will prevent the servant from hearing his pay-master's voice. Legal transfer means little so long as economic dependence continues."

The words of one court on this point also deserve careful consideration:

"The appointment of the owner, or one of his staff, as a warehouseman's custodian of goods stored, while not conclusively ineffectual, is nevertheless a circumstance to give pause, and must be carefully weighed in connection with the other facts in evidence."

In another case the court remarked:

"The custodian remained an employee of the pledgor and any possession he may have had was that of his employer."

Even if the warehouseman pays the custodian's salary a serious question would arise if it were established that the custodian is the same person who served as custodian or warehouse clerk for the borrower before the field warehouse arrangement was ever entered into, that he receives the same salary that he did from the borrower, that the warehouseman requires the storer or borrower to reimburse him for the salary of the custodian, and that it is understood by the custodian and storer that when need for the field-warehouse arrangement ceases the custodian will return to the employ of the storer. These facts would undoubtedly be referred to the jury in case of court action. Such facts could give rise to a serious question as to whether the field warehouseman ever had that exclusive and unequivocal possession of the goods that the law contemplates.

In considering this relationship of custodian and former employee the following language taken from a comprehensive opinion on field warehousing should arrest attention:

"Actual change of possession means existing in fact, and truly and absolutely carried out, as opposed to formal, potential, virtual, or theoretical change. The proof required to show actual change of possession is not measured by any fixed set of rules. Dependence must be placed upon the facts and circumstances of each particular case; and usually the determination must rest upon the finding of the court or the jury after hearing the evidence adduced on both sides."

The question as to whether an employee who has been transferred from the rolls of the borrower, or storer, in a field warehouse to the pay roll of the field warehouseman is a proper person to serve as custodian for a warehouseman who would issue receipts covering readily marketable staples which would be attached to bankers' acceptances as collateral, under the Federal Reserve Board's rules was referred by the Department of Agriculture to the Board of Governors of the Federal Reserve System. The Board's opinion appeared in the Federal Reserve Bulletin of March 1933 as follows:

"The Federal Reserve Board has had occasion to consider the question whether receipts proposed to be issued by a warehouse company under a certain field warehousing arrangement would comply with the requirements of the Federal Reserve Act and the board's regulations with reference to warehouse receipts securing bankers acceptances drawn to finance the storage of readily marketable staples.

"The following are the principal facts upon which the board's consideration and conclusion with respect to this question were based: It was proposed that premises, which were situated in several different localities should be leased to the warehouse company for the purpose of warehousing certain products owned by the lessor. It was understood that the warehoused products would be properly segregated from other goods on the premises in separate buildings or in portions of buildings partitioned off for that purpose and locked with the warehouse company's own locks and that conspicuous signs giving notice that the products thus segregated were in the custody of the warehouseman would be placed both inside and outside the premises. In the operation of these warehouses, however, the company was not to detail men already in its employ to take charge of the leased premises, but for this purpose was to transfer to its payroll employees of the lessor, paying them the same salary that they were receiving from the lessor at the time of the transfer. It was expected that these employees would be reemployed by the lessor at the close of the storage season or when the products had been removed from storage; but the warehouse company was to have the right to terminate their services at any time. These local custodians were to be the only representatives of the company at the warehouses; but periodical audits were to be made by auditors sent from the district office of the company which was located at a considerable distance from the proposed warehouses. 1/ The premises were to be leased at a nominal rental only and the lessor, in addition to paying a monthly storage fee, was to reimburse the warehouse company for all expenses, including the compensation of the custodians, the salaries and expenses of auditors, and the costs of the bonds which were to be required of the custodians. A local custodian was not to be permitted to issue warehouse receipts or to authorize releases, but these functions were to be

1/ Underscoring by author.

performed at the district office of the warehouse company upon the basis of statements signed by the custodian and a representative of the lessor.

"In order for a banker's acceptance drawn to finance the domestic storage of readily marketable staples to be eligible for rediscount by Federal Reserve Banks: (1) section 13 of the Federal Reserve Act requires that it be 'secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples'; and (2) Section XI of the board's Regulation A requires that it be 'secured at the time of acceptance by a warehouse, terminal or other similar receipt, conveying security title to such staples, issued by a party independent of the customer.'

"The requirement of the law that such warehouse receipts must convey or secure title to readily marketable staples obviously contemplates that the accepting bank shall have a lien on such staples which is valid and enforceable against general creditors of the person for whose benefit such acceptance credit is granted. Among the requirements generally recognized as essential to the creation of a valid lien through the pledge of warehouse receipts are that the warehouseman must take and maintain actual physical possession of the goods and that his possession must be exclusive and unequivocal. Under the arrangement above described, however, the actual possession of the goods would be maintained by persons closely identified with the owner of the goods and naturally subject to his influence. Such a custodian, who might be regarded by the owner and his creditors as the employee of the owner rather than of the warehouseman, probably would find it difficult to deny access to the premises of his former employer and the person to whom he looks for future employment. In the circumstances it is open to serious question whether the pledge of receipts issued under the arrangement described would fulfill the requirements for the creation of a valid lien.

"The requirement of the board's regulations that warehouse receipts securing bankers acceptances be issued by a party independent of the customer contemplates that the actual custody of the goods shall be maintained by an independent and disinterested party, so that the bank holding the warehouse receipt may be able to identify and obtain possession of the goods and thus enforce its lien without any difficulty. A lien on personal property is, of course, of no practical value unless such property can be found and identified when it becomes necessary to enforce the lien; and, if custody of the goods is not maintained by a disinterested party, there is danger that the goods may be improperly released or disposed of. In the case under consideration, whatever may be the theoretical requirements as to the

control and custody of the goods by the warehouseman, it is obvious that in fact the warehouseman would not be independent of the owner; because the warehouse company would have to rely upon its local custodians and they would not be independent of the owner.

"After carefully considering this question and studying all information received on the subject, the Federal Reserve Board expressed the opinion that bankers' acceptances issued against receipts, such as those proposed to be issued under the circumstances above described, are not eligible for rediscount at Federal Reserve Banks; because it is doubtful whether such receipts comply with the requirement of section 13 of the Federal Reserve Act that warehouse receipts securing bankers' acceptances drawn to finance the storage of readily marketable staples must convey or secure title to such staples, and because such receipts do not, in the board's judgment, comply with the requirement of section XI of the board's regulation A that warehouse receipts securing such bankers' acceptances must be 'issued by a party independent of the customer.'

"In giving expression to this opinion, the Federal Reserve Board did not undertake to pass upon the merits of field warehousing in general, either as conducted by the warehouse company in question or as conducted by any other company; and the board's opinion relates solely to warehouse receipts such as those proposed to be issued under the facts of the arrangement as above described."

Under every set of circumstances care must always be taken to avoid a set of facts which would cause a court to comment as one court did in an outstanding field warehousing case:

"The transaction is not changed by the form of the agreement under which it is cloaked. We are to look at the real purpose of the contract and not to the form or name given it by the parties."

In another case the United States Supreme Court stated:

"When there is conscious control, the intent to exclude, and the exclusion of others, with access to the place of custody as of right, these are all the elements of possession in the fullest sense.

"We deal with the case before us only. No doubt there are other cases in which the exclusive power of the so-called bailee gradually tapers away until we reach those in which the courts have held as a matter of law that there was no adequate bailment. So, different views have been entertained where the owner has undertaken to constitute himself a bailee by issuing

a receipt. We may concede, for purposes of argument, that all the forms gone through in this case might be emptied of significance by a different understanding between the parties, which the form intended to disguise."

In a most comprehensive case the court used this language:

"Warehousing on the premises of the owner proposing to pledge his merchandise is effective when done in obedience to legal requirements; but when done only far enough to get the goods represented by documents without really getting them stored, the documents are but scraps of paper. The term 'field warehousing' is not a talisman to give dominion by enchantment. Taking exclusiveness of possession and control as the criterion we find now and then a case where it may be said as a matter of law that, through the field warehouse, open, exclusive, and unequivocal possession has passed constructively to a pledgee; and then again in other cases we find that as a matter of law the possession of the warehouseman 'tapers away' to nothingness. Between these two extremes lies the aggregation of cases in which the facts are such that different men may with reason reach opposing conclusions. Cases of that character, when tried by a jury, must be allowed to go under proper instructions to the jury, for their determination of the facts in controversy."

CONCLUSION

The law on field warehousing is now so well defined that if those who attempt to render service in this field will make an honest effort to observe the limitations laid down in well-considered cases, and not attempt short-cuts with a view to accommodating prospective clients or storers, it should seldom if ever be necessary to submit the question of validity of receipts to a court, or the facts to a jury. What lender can afford to take a chance of submitting his loan collateral to a jury to determine whether the facts surrounding its creation give it legality.

The easiest course might be to follow the suggestion of a warehouseman, or the wishes and appeals of the banker's borrowing client. But the safest course is to follow well-established legal principles. A banker has a higher duty than merely to loan money. He too is a trustee of the property and interests of others. His first duty is that of a faithful servant to his trust, and he can be faithful to that trust when he lends money on field-warehouse receipts as collateral only as he makes it his business to ascertain what actual methods of operation prevail at the warehouse and how closely they square with well-established principles.

The experience of the Department of Agriculture is that the word of no interested party should be taken on this subject. Repeatedly it has found instances where storers, in spite of representations to the contrary, were carrying keys to the warehouses, had free access to the warehouses, and operated to all intents and purposes just as freely as they did before the alleged bailor-bailee relationship was undertaken. It has found cases where, in spite of statements to the contrary, the custodian was an employee of the storer, or at best had been transferred temporarily to the pay roll of the warehouseman with the definite understanding that when the warehouse arrangement was terminated his services with the warehouseman would cease. Such facts would be damaging evidence to submit to any jury.

Eternal vigilance is the price that the banker must pay if he wants to feel reasonably certain of the safety of his commodity loans collateralized by field-warehouse receipts.

In the administration of the United States Warehouse Act, when the Department of Agriculture came to consider field warehousing it was found necessary to superimpose special regulations upon its regular commodity regulations that are applicable to warehousemen who operate in the usual manner of public warehousemen.

To assist lending agencies in reaching a proper conclusion as to the collateral value of any field warehouse receipts which may be tendered them, the special regulations applicable to field warehousemen are appended herewith.

REGULATIONS SUPPLEMENTARY TO THE COMMODITY REGULATIONS UNDER
THE UNITED STATES WAREHOUSE ACT FOR FIELD WAREHOUSEMEN^{1/}

(Approved July 30, 1932)

Department of Agriculture
Washington, D. C.

By virtue of the authority vested in the Secretary of Agriculture by the United States warehouse act, approved August 11, 1916 (39 U. S. Stat. L., p. 486), as amended, I, R. W. Dunlap, Acting Secretary of Agriculture, do make, prescribe, publish and give public notice of the following rules and regulations to be known as the regulations supplementary to the commodity regulations under the United States warehouse act for field warehousemen, and to be in force and effect until amended or superseded by rules and regulations which may hereafter be made by the Secretary of Agriculture under said act.

In testimony whereof I have hereunto set my hand and caused the official seal of the Department of Agriculture to be affixed, in the city of Washington, this 30th day of July, 1932.



R. W. Dunlap

Acting Secretary.

SECTION 1. Definitions.--For the purposes of these regulations, unless the context otherwise require, the following terms shall be construed, respectively, to mean:

Paragraph 1. Commodity regulations.--Rules and regulations made under the act by the Secretary for warehousemen storing certain designated agricultural products.

Par. 2. Field warehouse.--A warehouse that is operated or is to be operated for the purpose of issuing warehouse receipts representing a disinterested custodianship of the products stored therein and which is leased from any person having a financial interest in the products.

Par. 3. Field warehouseman.--Unless otherwise clearly indicated by the context, any person lawfully engaged in the business of operating a field warehouse as defined in paragraph 2.

Par. 4. Custodian.--A person appointed or designated by a field warehouseman to supervise or manage a field warehouse licensed under the act.

Par. 5. Assistant custodian.--A person appointed or designated by a warehouseman to assist the custodian of a field warehouse in the supervision and management thereof.

SEC. 2. Nothing in these field warehouse regulations shall be construed to conflict with, or to authorize any conflict with, or in any way impair or limit, the effect or operation of the commodity regulations issued by the Secretary for warehousemen storing any specified product or products, but these regulations shall be considered as supplemental to all such commodity regulations and to be effective as to all field warehouses and field warehousemen operating under the act.

SEC. 3. Applications for licenses to operate field warehouses shall be made in accordance with the commodity regulations for warehousemen storing the particular agricultural product or products stored or to be stored in the field warehouse.

^{1/} These regulations were issued as Service and Regulatory Announcements No. 136 (B.A.E.) 1932.

SEC. 4. Compliance with all the preliminary requirements of the commodity regulations applicable to the agricultural product or products in question, as well as these regulations, shall be prerequisite to issuing a license to operate a field warehouse.

SEC. 5. There shall be no close relationship, either by blood or marriage, between the field warehouseman or his custodians and any depositor or the lessor of the field warehouse.

SEC. 6. Paragraph 1. No employee, either full or part-time, of any depositor, nor any person who is a close blood or other relative of any person occupying a supervisory or directing position in the business or organization of any depositor, or closely interested with any depositor in any business, shall be appointed as a custodian or an assistant custodian by a licensed field warehouseman; nor shall any person be appointed as a custodian or an assistant custodian if he has resigned from the employ of any depositor for the purpose of accepting employment from the warehouseman at the warehouse.

Par. 2. The compensation, or any part thereof, of any custodian, assistant custodians, or any other employee of the warehouseman, if any there be, must be paid by the warehouseman and not by any depositor. The custodian or assistant custodians need not be full-time employees of the warehouseman, but shall not be, under any conditions, part or full-time employees of any depositor of products in the warehouse.

Par. 3. Each person designated by a licensed field warehouseman as a custodian or an assistant custodian shall file with the bureau a statement, on a form provided by the bureau for the purpose, setting forth his qualifications and experience in warehouse work, the occupation or business he has been engaged in during the five years next preceding the date of the statement, the names of his employers, if any, during such 5-year period, the names of at least five persons who can vouch for his character and qualifications for the position, and such other information as the Secretary, or his designated representative, may require.

Par. 4. No custodian shall accept instructions from anyone other than the warehouseman.

Par. 5. No custodian or assistant custodian shall enter upon his duties as such at a licensed field warehouse until he has been notified in writing by the bureau that his appointment has been approved.

SEC. 7. The warehouse space licensed or to be licensed shall be substantially separated from other space and shall be kept securely locked or sealed in accordance with section 15 of these regulations. All keys to locks shall be kept in the possession of the warehouseman or his authorized agent at all times. In case there is any doubt whether all keys to the warehouse are in possession of the warehouseman or his agents the warehouseman shall provide new locks and keys for the warehouse.

SEC. 8. It shall be the duty of a licensed field warehouseman to keep the licensed field warehouse securely locked at all times except when the warehouseman, the custodian, or an assistant custodian is present, and no person other than the warehouseman, the custodian, or an assistant custodian shall have access to the licensed warehouse or the products stored therein except in the presence of and with the consent of such warehouseman, custodian, or assistant custodian: Provided, That if any night watchman in the employ of the owner of the building is required to enter the licensed warehouse under an insurance requirement and his only duties at the warehouse building are those of a night watchman he may be given a key to the warehouse for that purpose, if the approval of the bureau is first secured and the watchman's service is fully provided for in the field warehouse lease agreement: Provided further, That the provisions of this section shall not apply in the case of warehouses where the bin system is in effect as outlined in section 15 of these regulations. The warehouseman shall at all times exercise absolute and complete control and dominion over the licensed warehouse and the products stored therein to the complete exclusion of all parties except as provided herein.

SEC. 9. No misleading name or designation shall be applied to any field warehouse licensed under the act, but in every case the name shall indicate that the warehouse is being operated as a public warehouse by the warehouseman as lessee.

SEC. 10. Paragraph 1. Before a license to conduct a field warehouse is granted under the act, the warehouseman shall file with the bureau, in accordance with the requirements of the commodity regulations, a copy of his rules and a schedule of charges; and, in addition, he shall file copies of all contracts and agreements entered into by and between him and any depositor or the lessor of the field warehouse which in any way relate to the establishment, operation, management, or payment of expenses connected with the operation of the warehouse. If there are any agreements or understandings between the lessor of the warehouse and the lessee with respect to any of the aforementioned that have not been reduced to writing, the warehouseman shall file with the bureau a written statement setting forth the substance of such verbal agreements and understandings.

Par. 2. All warehouses licensed under the act must be operated as public warehouses, and no rules or schedules of charges filed by any warehouseman applying for a license under the act shall be approved by the Secretary, or his designated representative, if it is not clear that the requirements of section 13 of the act can and will be met.

SEC. 11. Every receipt, whether negotiable or nonnegotiable, issued for products stored in a field warehouse, shall, in addition to complying with the requirements of section 18 of the act and regulation 4 of the applicable commodity regulations, embody within its printed terms a statement that the warehouseman is lessee of the warehouse.

SEC. 12. Warehouse receipts for products stored in a field warehouse licensed under the act shall be issued in the town or city where the warehouse is located, except that where two or more licensed field warehouses are operated by a warehouseman receipts for all such warehouses may be issued from a central point, provided such central point is not more than 25 miles distant from the farthest warehouse. In cases where receipts are issued from central points the warehouseman shall, when requested by department representatives, provide transportation for such representatives, when engaged in regular inspection work, to and from such warehouses.

SEC. 13. No field warehouse license shall be issued by the Secretary, or his designated representative, unless the lessee is wholly disinterested with respect to depositors and the application is supported by the original lease and one copy, dated and signed by the contracting parties, and embodying the following: (a) A definite period of time not less than one year after the date of execution, (b) a description of the exact space leased to the field warehouseman and a statement that all of such space is to be covered by the license, if issued, and (c) evidence that said lease has been duly recorded in the county where such warehouse is located, except where there is a statutory inhibition against the recording of such leases, and (d) a clause prohibiting the cancellation of the lease or ejecting the warehouseman so long as any receipt issued under the act and the regulations is outstanding.

SEC. 14. A license to conduct a field warehouse under the act shall not be issued, or if issued, shall not be allowed to remain in effect, if any depositor agrees or has agreed with the warehouseman to indemnify him against loss due to failure of the warehouseman to exercise such care of the products in his custody as a reasonably prudent owner would exercise or as the warehouseman is required to exercise under the act and regulations.

SEC. 15. In the case of warehouses where approved storage bins have been erected and such bins can be sealed with seals furnished by the department for the purpose, the bins may be licensed and the depositors may, with the consent of the warehouseman, have access to such bins for the purpose of placing goods therein before the seals are affixed and before warehouse receipts are issued by the warehouseman, or for the purpose of removing goods



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therefrom after the outstanding receipts for all goods in such bin or bins have been surrendered to and cancelled by the warehouseman, and the warehouseman or his custodian, or assistant custodian, has broken the seals. Under no circumstances shall anyone other than the licensed warehouseman, the custodian, assistant custodian, or duly appointed employees of the Department of Agriculture in the performance of their official duties, affix any seals to a licensed bin or remove a seal therefrom. Where bins are licensed no receipts may be issued for products stored in any bin until after the seals have been affixed, and no seals may be broken for the purpose of delivering the products until the receipts covering such products have been surrendered and canceled. Seals may be broken to permit inspecting and reasonable sampling of the goods; but such work must be done by the licensed warehouseman, the custodian, or an assistant custodian, and after inspecting or sampling new seals shall be affixed to the bin.

SEC. 16. Paragraph 1. Each licensed field warehouseman shall, during the period of his license, maintain suitable signs on the licensed property in such manner as to give ample public notice that such property has been leased by the warehouseman and is controlled and operated by him. Such signs must be of such size and be so affixed to the outside of each licensed building, and at appropriate places within the building, as to attract the attention of and give notice to the public as to the real tenancy, and must be placed at each point of entry to and exit from the licensed space.

Par. 2. Such signs shall include the following: (a) The name and address of the licensee, (b) the name of the warehouse, (c) the license number of the warehouse, (d) a statement that the warehouseman is lessee, and (e) the words "Public Warehouse."

Par. 3. Such other wording or lettering as is not inconsistent with the purpose of the act and these regulations and is approved by the bureau may appear in the sign or signs.

Par. 4. The warehouseman shall not permit signs to remain on his licensed property which might lead to confusion as to the tenancy.